FRONTIERS OF FREEDOM

Senator Malcolm Wallop (ret.)
Chairman

GEORGE C. LANDRITH
Executive Director
(703) 527-8282 Ext. 105

January 31, 2000

David S. Guzy
Chief, Rules and Publications Staff
Royalty Management Program
Minerals Management Service
P.O. Box 25165
M.S. 3021
Denver, CO 80225-0165

Re: *Establishing Oil Value for Royalty Due on Federal Leases, Further Supplementary Proposed Rule*, 64 Fed. Reg. 73820 (Dec. 30, 1999).

Dear Mr. Guzy:

Frontiers of Freedom appreciates the opportunity to comment on the proposed rule.

Frontiers of Freedom is a non-profit, non-partisan public policy advocacy organization solely dedicated to maintaining and restoring the American system of limited government and individual rights. Our work also involves the advancement of States' rights and the protection of property rights. Frontiers has been monitoring the progress of the crude oil valuation rulemaking process since before May 1998 when we published a study entitled, "Resolving the Federal Oil and Gas Royalty Valuation Dispute: A Free Market Approach." In August of that same year, Frontiers conducted a Citizen's forum in Casper, Wyoming featuring industry and government spokesman. We have become alarmed by the events of the last nine months surrounding this particular rule.

In late April 1999, members of the press began informing the public of an investigation into the improprieties of two government employees who accepted payments from the Project on Government Oversight ("POGO") for their work on the proposed rule. Exhibit 1. POGO, a relator in a False Claims case in Texas, did not deny the payments to Robert Berman, a policy analyst with the Department of the Interior, and Robert Speir, a policy analyst formerly with the Department of Energy. Exhibit 2.

The revelation of possible improper influence on the proposed rule by Mr. Berman and Mr. Speir calls into question the integrity of the rulemaking process as a whole. In a hearing before a Senate Energy Subcommittee, Senator Frank H. Murkowski stated "the process

1401 WILSON BOULEVARD · 10TH FLOOR · ARLINGTON, VIRGINIA 22209
PHONE (703) 527-8282 · TOLL FREE (888) 8-RIGHTS · FAX (703) 527-8388 · INTERNET HTTP://WWW.FF.ORG

obviously is tainted by the allegations of payoffs and of perception that certain special interests ... have undue roles and undue influence in the process." Exhibit 3, page 7. Frontiers is concerned that the fundamental structure of the rule, and many of its explicit provisions, comes from the views of people who have a personal stake in having the Department of the Interior adopt their positions. Senator Don Nickles stated that "when we read reports that two Interior Department officials received payments of $350,000 each, and that they advocated a position that is very zealous in favor of moving royalties downstream, as proposed by the administration, to increase payments, I find that to be grossly unethical. I find that to be offensive." Exhibit 3, page 23.

This past fall, Senator Murkowski vigorously advocated his position that the rulemaking process be postponed until a complete investigation of "payoffs" of government officials involved in the rulemaking could be conducted. Exhibit 4; Exhibit 5. Frontiers concurs with the strong positions taken by Senators Murkowski and Nickles. Because the results of any rulemaking process affect every citizen of this nation, Frontiers finds it necessary to remind the Minerals Management Service (MMS) that the responsibility of government officials involved in the rulemaking process is to protect the rights and interests of the people at large, and not the rights and interests of private, special interest groups.

In examining the proposed rule and the events surrounding its creation, Frontiers discovered that the influence by private parties on the rulemaking process goes back farther in time than the American people have been led to believe.

<u>The Payments</u>

Contrary to POGO's initial explanation that the payments were public service awards to "whistleblowing" public servants, Exhibit 2, evidence has come to light revealing that the payments were part of a long-term arrangement.

In November 1998, Berman and Speir each received $383,600 from POGO. Exhibit 6, Exhibit 7. The payments were made under a written agreement dated January 5, 1998. Under that agreement, Berman, Speir, and POGO would share one-third each in any recovery POGO obtained from federal lessees in lawsuits brought under the False Claims Act. Exhibit 8. The 1998 agreement basically codified a "standing oral agreement" which was in place at least as early as December 1996. Exhibit 8. The November 1998 payments came from a settlement between the United States and Mobil Oil Corporation. POGO received its share under the terms of a still-secret sharing agreement between POGO and other participants in a lawsuit pending in the Eastern District of Texas called United States ex rel. Johnson v. Shell Oil Company. Because of these two agreements, POGO, Berman, and Speir stand to gain additional money from subsequent settlements.

The Proposed Rule and Its Chief Advocates

Under the Department's proposed rule, the Department will no longer follow its historical practice of using arm's-length sales at the lease to value royalties on crude oil. Instead, it will require affiliated companies to trace their inter-company sales to downstream locations or to use so-called spot market index prices at market centers. For California oil, the price is based on spot prices for Alaska North Slope (ANS) oil sold in Los Angeles or San Francisco. For oil in the Rocky Mountain region, the price will typically be based on spot prices of West Texas Intermediate crude oil traded at Cushing, Oklahoma. (The New York Mercantile Exchange (NYMEX) trades in futures contracts for West Texas Intermediate oil delivered at Cushing.) For everywhere else, the price will be based on spot prices at market centers such as St. James, Louisiana, or Midland, Texas. The rule also requires companies to disregard completely any sales to an affiliated company. The Department's former position was that those sales could be used for royalty valuation if they were for prices similar to those in comparable arm's-length sales.

Frontiers has reviewed documents concerning the POGO payments and found that the principal authorities and consultants on which the Department has relied in changing its policy are persons with a direct financial stake in the policy change (or persons in business partnerships with them). These persons have claims to money under litigation brought under the False Claims Act in a case called United States ex rel. Johnson v. Shell Oil Company. In addition to Berman and Speir are Mr. J. Benjamin Johnson of Summit Resource Management, Inc., and Mr. Peter Ashton of Innovation and Information Consultants, Inc. (Ashton has no direct stake in the litigation, but is now Speir's business partner; both have been retained by the Department of Justice in the U.S./Johnson v. Shell case.)[1]

Evidence of Influence on the Rulemaking Process

The seminal period in the change of policy was between the fall of 1993 and the end of 1996. Two separate initiatives converged during that period. The first became the subject of public attention in June 1994, when former Assistant Secretary Bob Armstrong assembled the

[1] To be clear, Frontiers is not suggesting that the conduct of Johnson or Ashton has been in any way improper. It is the Department's conduct which the record calls into question.

Interagency Task Force ("Task Force") to examine the issue of undervaluation of oil royalties from federal leases in California. The most active and vocal member of the Task Force was Speir, who was quick to criticize others on the Task Force by challenging their disagreements with him as a continued effort to cover up underpayments. Exhibit 9. Speir urged the Task Force to find that the true value of oil produced from federal leases in California was the price received for ANS crude oil sold in Los Angeles or San Francisco. Exhibit 10, page 68. After receiving information from Task Force consultant Ashton, the Task Force adopted that view and recommended that the Department's value regulations be amended. Exhibit 10, page iii.

The inter-agency approach had first been proposed by Berman in August 1993. Exhibit 11. Mr. Berman was in contact with POGO throughout this period, even helping POGO draft requests for documents under the Freedom of Information Act. Exhibit 12, page 72. POGO, for its part, kept media attention on the Department by providing internal Department documents to the news media and by publishing reports highly critical of the Department for "winking and nodding" at industry's alleged underpayments.

The tie between POGO and the Task Force appears to have been close. A frequent participant in Task Force meetings was a lawyer in private practice, Henry Banta, and one of his law partners, who were present on behalf of their client, the State of California. Banta was also the Chairman of POGO's Board of Directors and had been the one responsible for involving POGO in the California oil royalty issue beginning in 1994. Exhibit 13, page 23. It is unknown whether Banta ever disclosed to Task Force members his role with POGO.

In June 1996, one month after the Task Force Report was presented, a House Subcommittee chaired by Representative Horn held a hearing on the issue of oil valuation. POGO arranged to have Berman and Speir called to testify. Exhibit 13, page 219. Both testified that the use of ANS spot and NYMEX prices would be a better valuation method than the use of posted prices. Exhibit 14, pages 35, 39-40, 54-55 (Berman); 41, 58-59 (Speir).

The second initiative at work during this period concerning oil produced east of California. In 1994 and 1995, Johnson approached state, federal, and private royalty owners about his services in helping them obtain higher royalties on crude oil. In February 1996 Johnson filed a lawsuit on behalf of the United States -- which by law remained secret to all except employees of the United States government until disclosed by court order two years later -- under the False Claims Act against numerous federal oil lessees. In his suit, Johnson alleged that the lessees had fraudulently undervalued their royalty payments to the Interior Department. He requested that he receive up to 30 percent of any royalties recovered.

While his suit was pending, MMS (fully aware of his pending suit) retained Johnson as a consultant on the proposed oil value rule. In September 1996, Johnson made a presentation to MMS of his analysis of existing crude oil valuation methods and potential alternatives. In his presentation, he, too, recommended the use of NYMEX and ANS spot prices for the valuation of crude oil. Exhibit 15.

Involvement in the Proposed Rulemaking

In December 1996, POGO informed the organization's Board of Directors that "an agreement [had] been worked out that if there [was] some reward, whatever and whenever an amount would be won, that the individuals that have been doing this work for years would be compensated." Exhibit 15. POGO has acknowledged these individuals to be Robert Berman and Robert Speir.

The day after POGO's Board meeting, Bill Bettenberg, Mr. Berman's superior, sent Assistant Secretary Armstrong Mr. Berman's paper discussing alternative approaches to valuation of oil for royalty calculation purposes. Exhibit 16. Mr. Berman's paper provides a detailed explanation for the use of ANS spot and NYMEX prices.

Although he initially disclaimed any role in the Department's proposed rule, Exhibit 16, Speir subsequently acknowledged that he remained involved in the issue before retiring from the Department of Energy. In September 1996, Speir sent an e-mail to MMS informing that he would be commenting on the proposed rule on behalf of the Department of Energy. Exhibit 17. He communicated with MMS again during the rulemaking. Exhibits 18-20.

In January 1997, MMS published its notice of proposed rulemaking for crude oil valuation. Establishing Oil Value for Royalty Due on Federal Leases, and on Sale of Federal Royalty Oil, 62 Fed. Reg. 3742 (Jan. 24, 1997). It is in this initial proposed rule that it becomes apparent to Frontiers when the views of Mssrs. Berman, Speir, and Johnson – the use of ANS spot prices for California oil and NYMEX or market center prices for other oil – became the views of MMS.

What They Recommended, What MMS Has Proposed

Mr. Speir:

- "I have always felt that Alaska North Slope oil is the proper basis of valuation." Exhibit 14, page 58. "Establish[] the value of California crude oil based on quality- and transportation-adjusted open-market prices of ANS oil." Exhibit 10, page 68. MMS has proposed that, for California crude oil, "value is the average of daily mean ANS spot prices adjust[ed] for applicable location and quality differentials and ... for transportation costs." Proposed section 206.103(a) and (a)(3).

- "[D]o away with any recognition of affiliate transfers. Define the lessee to be the parent corporation and all its consolidated and unconsolidated entities that it directly or indirectly controls." Exhibit 17. Proposed section 206.102(a)(2) does away with any recognition of affiliate transfers.

- "My recommendation remains that DOE not comment on the proposed regs." Exhibit 20. DOE has not commented on the proposed rules.

Mr. Berman:

- "If you take a valuation system based on the alternative crude, and the market prices of crude, that would lend toward an ANS valuation system which is more straight forward." Exhibit 14, page 35. "I believe the best method of measuring value in California is through reference to ANS, since ANS was entered into California markets." Exhibit 14, page 54. The proposed rule adopts this view.

- For mid-continent and Texas, "I would probably use closing price on the NYMEX when it goes from future to spot." Exhibit 14, page 55. "Because crude markets differ geographically, a combination of [NYMEX closing prices, spot prices, market basket of crudes, and gross proceeds] should be used to value crude oil for royalty purposes." Exhibit 21, page 1. MMS agrees. It initially proposed to rely heavily on the NYMEX price is its January 1997 proposal. "The main difference [between the 1997 proposal and the current proposal] is that rather than using NYMEX futures prices, we apply Cushing spot prices in this proposal...." 64 Federal Register page 73831.

Mr Johnson.

- MMS's January 1997 proposed rule appears to come directly from Johnson's September 1996 presentation to the agency's rule writers. Exhibit 15 .

- The 1996 presentation still shows influence in the current proposed rule in how the agency views exchange agreements, "overall balancing" agreements, market center pricing.

Mr. Ashton:

- His views on the use of ANS pricing for California oil are openly relied on by the agency. 64 Federal Register page 73824.

How Private Interests Stand to Benefit from the Proposed Rule

Frontiers is concerned that the rulemaking process has been tainted by the influence of people who have a personal stake in having the Department of the Interior adopt their positions. Mssrs. Berman and Speir, government officials, have a written agreement with POGO, the terms of which require POGO to share equally any proceeds it receives from the lawsuit in Lufkin, Texas, with the two men. Exhibit 8. Thus, the more money POGO receives, the more money Mr. Berman and Mr Speir receive.

How would POGO benefit from the implementation of the proposed rule? Experience under the False Claims Act shows that cases are rarely successful unless the private plaintiffs can persuade the federal government to intervene on their behalf. Frontiers believes that the effort to amend the existing oil value was part of an overall strategy to assure that the Department of Justice would intervene in the Texas lawsuit in which POGO was a plaintiff. The implementation of the proposed rule would be used to validate POGO's claims that the old system was being manipulated.

Recommendations

The evidence we provided clearly documents the depth of involvement of these two men in the proposed rulemaking process, and we can see the results of their continued "work" in various provisions of the proposed rule. The press has informed the American people that federal investigative bodies are examining the events surrounding these legally questionable payments to Mssrs. Berman and Speir

Frontiers strongly believes that it would be in the best interests of the Department and the American people to postpone this rulemaking until all investigations are complete. Frontiers of Freedom appreciates the opportunity to submit these comments to MMS, and sincerely hopes the MMS remembers that its priority is the benefit of the American people.

Respectfully submitted,

George C. Landrith

Attachments

Speir in fact defended POGO, stressing the group was solely responsible for rsuing the case.

"POGO has forced the government to collect a large amount of money toward e underpayment of royalties by the oil companies," Speir added.

The US Justice Department declined to comment on the case.

Berman reportedly accepted the money from POGO after the public interest oup won $1-mil last year as part of a larger $45-mil settlement between bil, the government, POGO and other private individuals under the False aims Act. POGO, along with several private individuals initially brought on e civil action against 16 oil companies for allegedly conspiring to underpay l royalties to the federal government. Mobil opted to settle after the vernment decided to intervene against several of the oil companies involved. obil denied any wrongdoing in that case.

The civil lawsuit against the other companies is still pending, along with a parate crimimal investigation against Burlington Resources.

The two government employees helped POGO with information but opted not to part of the civil lawsuit. But after POGO received settlement money from e Mobil case, the group decided to share the proceeds even though the two re not parties in the suit.

POGO informed the US Justice Department last year that it planned to give e money to the two men. Sources familiar with the case say they are puzzled to why Justice now is going ahead with a review.

"POGO has been privileged to work with whistleblowers over the years, and it emed only fair that the two unsung heros be compensated in keeping with the irit of the False Claims Act," the group said in a statement.

It is unclear whether Berman consulted government attorneys before accepting e money. Speir's alleged payment took place a year after he left DOE.

---- INDEX REFERENCES ----

OMPANY (TICKER): Burlington Resources Inc. (BR)

EWS SUBJECT: World Equity Index (WEI)

TORY ORIGIN: WASHINGTON

NDUSTRY: Oil-Secondary (OIS)

ord Count: 564
/30/99 PLATTON 1
ND OF DOCUMENT

Copr. © West 1999 No Claim to Orig. U.S. Govt. Works

itation | Search Result | Rank 3 of 21 | Database
/30/99 PLATTON 1 | PLATTON
/30/99 Platt's Oilgram News 1
999 WL 12178620

Platt's Oilgram News
Copyright 1999 McGraw-Hill, Inc.

Friday, April 30, 1999

Vol. 77, No. 82

US JUSTICE REVIEWS PAYMENTS TO EMPLOYEES FROM OIL VALUATION SUIT

Maureen Lorenzetti

The US Justice Department is conducting an internal review of a US Department of Interior employee who reportedly accepted money from a public interest group for his role as a whistleblower in an oil valuation investigation, government and other sources close to the case said Apr 29.

Justice is seeking to determine whether it was appropriate for Robert Berman, an official with Interior's policy office, to accept about $350,000 from the Project on Government Oversight.

According to POGO, the money was given to Berman and a retired Department of Energy policy analyst, Bob Speir, for their work in the mid-1990s in helping to expose underpayment of royalties.

POGO sued oil companies for alleged royalty underpayments under the False Claims Act in 1997. No formal criminal investigation is pending, sources familiar with the case stressed. Rather, US civil attorneys in the Justice Dept are seeking an opinion from criminal attorney counterparts on whether Berman's actions were appropriate as a public official.

Berman declined to comment on Justice's decision to conduct an internal review.

"You'll have to talk to the US Justice Department about that," said Berman when asked by Platt's in a brief telephone interview.

Speir, while not acknowledging the receipt of funds from POGO, said he did not consider himself a whistleblower in this matter.

He also noted that the funds in question were dispersed by POGO a year after he left government service.

"While I have heard the Justice Department is investigating this matter, I have not been contacted by them or advised by them that I am the subject of investigation."

Copr. © West 1999 No Claim to Orig. U.S. Govt. Works

tion Search Result Rank 53 of 120 Database WIRES
/99 DJES 19:23:00
9/99 Dow Jones Energy Serv. 19:23:00

Dow Jones Energy Service
Copyright (c) 1999, Dow Jones & Company, Inc.

Wednesday, May 19, 1999

=U.S. Federal Oil Royalty Valuation Debate Heats Up

ASHINGTON (Dow Jones)--The long-running debate over a new U.S. government e on crude oil and natural gas royalties heated up this week amid new egations from the rule's supporters and critics.

n a letter sent Wednesday to Secretary of Interior Bruce Babbitt, three oil- ch senators asked that the Interior Department's new royalty valuation rule suspended until conflict-of-interest issues are resolved.

he letter refers to recent disclosures about Clinton administration icials involved in mineral royalties policy. It is signed by Senate Energy Natural Resources Chairman Frank Murkowski, R-Alaska, Sen. Pete Domenici, .M., and Sen. Don Nickels, R-Okla.

'he Department of Justice and the Interior Department's inspector general are estigating payments to two federal employees after an oil company settlement royalty underpayment allegations. They payments of $350,000 each were legedly from Danielle Brian, executive director of the Project on Government ersight.

The letter says one of the employees, now retired from the Department of ergy, was part of an interagency task force working on the new royalty rule. e other employee is currently an employee of the Department of Interior's fice of policy analysis, according to the letter.

The senators have been among the new rule's most vocal critics, arguing that unfairly burdens oil and gas producers. They and other Congressional ponents of the rule have placed it under moratorium until June 1 and have ssed a bill to extend that moratorium until Oct. 1.

The new rule would have companies calculate percentage royalties owed to the ederal government based on reported market prices rather than on their own osted prices. The rule's supporters say the posted prices are consistently ower than market prices.

Oil companies agree a new system is needed, but they want more allowances ade for the cost of marketing their oil and gas and limits on their exposure o audits.

Rep. Maloney Says Cos. Underpaid By Up To $2 Bln

/99 DJES 19:23:00

anwhile, Rep. Carolyn Maloney, D-N.Y., issued a report Wednesday finding major oil companies owe up to $2 billion in royalties for production from ral lands.

'his report...proves that big oil companies have stolen money from our .on's taxpayers, our schools and our environment, only to fatten their :om line," Maloney said.

ie report extrapolates from documents made public as a result of the ifornia and Long Beach City governments' 1974 lawsuit against several major companies for underpaying royalties.

aloney said the Interior Department's new valuation rule needs to take ect to avoid further royalty underpayments. She described the conflict-of-erest accusations as a diversionary tactic by oil industry supporters.

fficials at the Interior Department's Minerals Management Service couldn't ediately be reached for comment on the conflict-of-interest allegations.

MS estimates large, integrated oil and gas companies would owe an litional $66 million a year in federal royalties under the new rule but that aller companies wouldn't be affected.

at the behest of Congressional critics of the rule, MMS reopened the rule to ic comments earlier this year and has since held talks with petroleum ustry representatives. The latest comment period ended in late April, and MMS is now considering whether to make adjustments to the rule.

-By Campion Walsh: 202-867-0291;
campion.walsh@dowjones.com

(END) Dow Jones Newswires 10-05-99

2323GMT

---- INDEX REFERENCES ----

WS SUBJECT: Dow Jones News Wires; Energy Service; Natural Gas; Petroleum Market; Securities Registrations; Corporate Actions (DJWI NRG LNG PET REG CAC)

RODUCT: Washington News and Views (DWV)

OVERNMENT: Congress (CNG)

EGION: North America; United States (NME US)

Word Count: 539
/19/99 DJES 19:23:00
OF DOCUMENT

Copr. © West 1999 No Claim to Orig. U.S. Govt. Works

The Project On Government Oversight

CONTACT: Danielle Brian
(202) 466-5539

Updated April 30, 1999, 3:00 pm

Statement of Danielle Brian Regarding Proceeds POGO Received from False Claims Act Settlement with Mobil

WASHINGTON, DC – The Project On Government Oversight (POGO) shared the proceeds from a Fall 1998 lawsuit settlement with two government whistleblowers. The settlement with Mobil Oil Corporation resulted from a False Claims Act lawsuit over oil royalty under payments. Executive Director Danielle Brian offered the following statement:

"In 1993, POGO began investigating and exposing the oil industry's under payment of royalties for oil they drill and produce on public lands. During our work issuing reports, and working with Members of Congress and the Administration to correct this corporate handout, we came across two men who had already been trying to fix this problem from within the bureaucracy for years previously. In December 1996, when we began exploring the possibility of filing a False Claims Act lawsuit, we approached these two whistleblowers, to see if they were interested in joining us. Not surprisingly, despite the possible financial reward, they feared joining the suit would mean certain retaliation, as well as an end to their careers in the government, and elected not to join us. POGO then decided that in the unlikely event that we did receive money as a result of this suit, we would still share it with these courageous individuals. We were proud to be able to make these awards to these two men.

In Fall 1998, Mobil agreed to pay $45 million to settle its lawsuit with the federal government from which POGO received $1.2 million. POGO notified the government of its intention to split the settlement with the two government whistleblowers and then awarded them each approximately $350,000.

Whistleblowers exposing government fraud often risk retaliation in the form of job loss, harassment and demotions. Yet, these loyal public servants have played a central role in fixing many serious problems within government. POGO has been privileged to work with whistleblowers over the years, and it seemed only fair that the two unsung heros be compensated in keeping with the spirit of the False Claims Act."

Founded in 1981, POGO's mission is to investigate, expose, and remedy abuses of power, mismanagement, and subservience by the federal government to special interests.

###

S. HRG. 106-192

FEDERAL ROYALTY CERTAINTY ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY RESEARCH, DEVELOPMENT, PRODUCTION AND REGULATION

OF THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

ON

S. 924

ENTITLED THE "FEDERAL ROYALTY CERTAINTY ACT"

MAY 18, 1999

Printed for the use of the Committee on Energy and Natural Resources

U.S. GOVERNMENT PRINTING OFFICE

59-9[illegible]6 CC WASHINGTON : 1999

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-059607-6

at royalty in-kind and so on. So I commend you for your legislation and for holding the hearing, and I would like to participate with you.

Thank you.

[The prepared statement of Senator Thomas follows:]

PREPARED STATEMENT OF HON. CRAIG THOMAS, U.S. SENATOR FROM WYOMING

Mr. Chairman, I want to thank you for holding this hearing today to discuss S. 924, the "Federal Royalty Certainty Act." I also want to welcome Steve Reynolds, who is the Director of the Office of State Lands and Investments for the State of Wyoming, to the Energy Committee.

The issue of oil and gas royalty valuation and collection is something I have worked on for a very long time. The petroleum industry plays an important role in the economy of the State of Wyoming and much of the production in my state comes from lands administered by the federal government. Unfortunately, the federal agencies continue to take actions that will reduce the amount of oil and gas produced in Wyoming and cause additional economic hardship for the people of my state.

The latest effort by the Minerals Management Service (MMS) to promulgate new oil valuation rules is another example of the Clinton Administration's misguided efforts. Although the MMS claims this proposed rule is about getting a fair share of royalties for the federal government for minerals produced on public lands, nothing could be further from the truth. The MMS proposed valuation rule will have one effect—to create further economic hardship for domestic oil and gas producers.

Contrary to the arguments of the MMS and the Administration, domestic oil and gas producers already pay significant amounts of money in federal royalties. In fact, the industry pays billions of dollars annually in royalty payments. No one argues that producers should not pay a fair royalty for production on federal lands, however, the MMS, proposed valuation rule is complicated and unworkable. It will result in increased costs to producers and kill jobs in the oil patch.

Let me also stress the need for the Committee to thoroughly analyze efforts to establish a "royalty-in-kind" payment system. I understand that the bill before us today does not address the issue of royalty-in-kind directly. I commend Senator Nickles for introducing this legislation which will allow us to address the most immediate issue regarding the valuation rule and take a broader look at the entire question of RIK.

Mr. Chairman, thanks again for holding this hearing today. I look forward to hearing the testimony of the witnesses.

Senator NICKLES. Thank you.

Senator Murkowski.

STATEMENT OF HON. FRANK H. MURKOWSKI, U.S. SENATOR FROM ALASKA

The CHAIRMAN. Thank you, Senator Nickles. I will be brief.

I support the bill because it values the Federal oil lease, and says that when sales happen away from the lease, genuine costs relating to such sales are deductible. I think it is straightforward and fair. It is the way the Canadian Province of Alberta has done this for a long period of time. And, basically, they do not have this valuation problem and confusion that goes with it. Alberta certainly has had an opportunity to, as a frontier Province, address all the pros and cons associated with value.

What we have got here is we have got allegations of wrongdoing. We have got reams of lawsuits. It is a full employment act for the lawyers, some of whom are out there this afternoon. I recognize that and I am sensitive to your well-being, but not quite that sensitive.

[Laughter.]

The CHAIRMAN. We have got legions of auditors. We have got suggestions now that government employees are taking cash for advocating rule changes within government. We have got some examples of that, but I am not quite ready to break that. But it is going to break. And it is going to be very embarrassing, because there are legitimate questions here that have to be answered and, on the surface, there does not appear to be a legitimate answer.

The latest allegation that Federal employees have been paid for their role in changing regulations surrounding oil valuation calls into question the very integrity of this rulemaking process. And until these investigations are concluded, the process obviously is tainted by the allegations of payoffs and of perception that certain special interests—trial lawyers and affiliated organizations—have undue roles and undue influence in the process. In other words, ladies and gentlemen, there is big money here.

I hope the Secretary recognizes the public integrity questions these payments to Federal employees and what it raises. It raises questions and suspicions that the rule of the Government investigators is somehow colored, if you will, in situations of this nature. I would encourage you, in the meantime, to move forward to clarify the law, put the lawsuits, the countersuits and the endless audits behind us. I think our domestic energy industry needs the certainty and the fairness that this bill provides.

Thank you, Chairman Nickles, for proceeding in this area, and we look forward to doing some heavy lifting here.

Senator NICKLES. Thank you, Mr. Chairman.

Our first witness will be Thomas Kitsos, Deputy Director of MMS, Department of the Interior.

STATEMENT OF THOMAS R. KITSOS, DEPUTY DIRECTOR, MINERALS MANAGEMENT SERVICE, ACCOMPANIED BY LUCY QUERQUES DENETT, ASSOCIATE DIRECTOR FOR ROYALTY MANAGEMENT, DEPARTMENT OF THE INTERIOR

Mr. KITSOS. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear before you today to provide the Department's initial analysis of S. 924, the Federal Royalty Certainty Act. Having received a copy of the bill only recently, our analysis at this point is preliminary and I hope that you will keep that in mind. We will have a more detailed analysis as soon as we can.

As we understand it, the bill is intended to eliminate or greatly reduce administrative costs of the current royalty program by providing simple, clear and certain guidelines, and categories of adjustment to value when sales are made downstream of the lease. MMS is also interested in obtaining simplicity, clarity and certainty while we strive to minimize royalty disputes and assure a fair return for the public's natural resources.

Mr. Chairman, we are concerned that this bill will fall short of its objectives, fundamentally alter the historical relationship between the Government as lessor and the industry as lessees, and, as a result, cost the American taxpayers perhaps as much as $250 million a year in lost revenues. In short, given our initial review of this bill if passed by the Congress, the Secretary would find it necessary to recommend a veto to the President.

We welcome, however, the opportunity to work with you and the members of the committee on this issue. We believe that a better

Senator DOMENICI. Let me talk one minute about this $250 million. Actually, you do not have any idea what this bill would cost? This $250 million has to do with if you were to get your oil in-kind, and you start figuring out how much you would lose if it was an in-kind transaction, and you are in some way relating that to this bill?

Mr. KITSOS. No. What I meant to say was that in the process of analyzing the cost of the RIK bill that was introduced in the House last Congress, we put together some data on processing, on sweetening oil and gas, on all those processes, and we used some of those numbers to try to determine the impact of this bill. We have not had as much time as we would like, and we are not saying that this bill is the RIK bill. We just used some of that data.

Senator DOMENICI. All right. I want to tell you personally that I have been fortunate, or unfortunate, to be in an awful lot of negotiations around this place—sometimes ad nauseam. When we deregulated oil and gas early on, which Don Nickles did not think was enough, way back yonder when we did it, we were there 9 weeks negotiating. I have had 3, 4 and 5 weeks with budget negotiations. But, frankly, I sat in on three meetings at the request of MMS and the industry. And that is all I could stand. So it does say something about what I perceive you all are doing.

I never saw so much nitpicking and so much "Well, maybe we will come back in a week." Frankly, if they would have invited me back again—although you are all wonderful people and the lady who was in charge, although I mistook her heretofore, I did not know that she was in charge, I thought she was legal counsel because she sounded just like a lawyer representing the organization—but, aside from that, and all of you are nice people, I do not think I would have gone back even if the industry would have asked me. So you have got a tough job. I hope it works.

Mr. KITSOS. Thank you, Senator.

Senator NICKLES. Senator Domenici, thank you.

Let me just ask a couple of quick questions, Mr. Kitsos. Do you plan to re-propose the rule on oil valuation, given the substantial comments that you have received from industry's proposals?

Mr. KITSOS. That is a decision that will have to be made this summer, hopefully in June. When we get the information from our royalty management folks and they put together some decision documents, we will have to determine the direction in which we are moving. We will have to determine whether the direction in which we are moving is substantively and significantly different from the last proposed rule. If it is, then we will have to re-propose. But that is a decision down the line that will have to be made fairly soon.

Senator NICKLES. It will be made when?

Mr. KITSOS. Fairly soon. This summer.

Senator NICKLES. Well, I hope that you would take those comments into consideration. I know you have received a wealth, a multitude, of comments. And I hope that they are not made in vain. I hope you did not go through the exercise of asking for the comments, and ignore them.

Mr. KITSOS. We took them very seriously.

Senator NICKLES. When I stated and showed that diagram and told you that I have heard from a lot of people, saying your proposal will not work—when you are trying to move royalty valuations downstream, you have added a lot more ambiguity into it than what maybe you even realize. And so you will increase the uncertainty. Therefore, you will increase the ambiguity, the litigation, the confusion. That is not what you said you wanted to do.

Mr. KITSOS. That is correct. We want as predictable a system as possible. And that is what we are working for, Senator.

Senator NICKLES. Let me ask another quick question. Can you tell me what Robert Berman does for the Department of the Interior?

Mr. KITSOS. He works in the Office of Policy and Budget. And that is really all that I can tell you at this point. With respect to Mr. Berman, his situation is under investigation by the I.G. and the Department of Justice. And that is all that I am at liberty to say at this point. I do not really know him.

Senator NICKLES. Has he worked on the MMS regulatory change?

Mr. KITSOS. Senator, I am instructed that all I can tell you is that this is currently being investigated by the I.G. and the Justice Department.

Senator NICKLES. Are press accounts accurate, that he received $350,000 as a payment for his efforts on royalty valuation?

Mr. KITSOS. Senator, I cannot respond to that. I am sorry.

Senator NICKLES. You cannot respond, so it is accurate, it is not accurate?

Mr. KITSOS. I cannot respond on whether it is or is not accurate.

Senator NICKLES. Do you know?

Mr. KITSOS. No, I do not know. I mean I know of the reports, but I do not know about its accuracy.

Senator NICKLES. Do you think it would be inappropriate for an Interior Department official to be working on regulations dealing with oil and gas royalties, to have someone sue the Government or sue companies and receive a payment of $350,000?

Mr. KITSOS. Senator, I think that would be a difficult decision for somebody to make. But I cannot comment on that.

Senator NICKLES. A difficult decision to take $350,000. If Senator Domenici is working on this legislation and we found out somebody had paid him $350,000 because of his position, do you think that would be okay? We may be on to something here if this is okay.

[Laughter.]

Senator DOMENICI. It is the same thing as if he did it.

[Laughter.]

Mr. KITSOS. I think clearly there are ethical questions that are raised about that situation, Senator. I think I can say that.

Senator NICKLES. Mr. Kitsos, Secretary Babbitt, and others, we need to get answers here. A lot of us have been working on this problem Senator Domenici mentioned for 2 years. And then, when we read reports that two Interior Department officials received payments of $350,000 each, and that they advocated a position that is very zealous in favor of moving royalties downstream, as proposed by the administration, to increase payments, I find that to be grossly unethical. I find that to be offensive. And I would like to have your attention while I am talking to you.

Mr. KITSOS. I am sorry, Senator.

Sent By: FRONTIERS OF FREEDOM; 703 527 8388; Jan-31-00 5:37PM; Page 17

Larry E. Craig, Bill Frist, Michael Crapo, Don Nickles, Craig Thomas, Chuck Hagel, Christopher Bond, Jon Kyl, Peter Fitzgerald, Pete V. Domenici, Phil Gramm, and Slade Gorton.

The PRESIDING OFFICER. The Senator from Texas.

Mrs. HUTCHISON. Madam President, in view of the fact that seven of our Members are missing, I ask unanimous consent to move the cloture vote to tomorrow following the votes at 10:30.

The PRESIDING OFFICER. Is there objection?

Mrs. BOXER. I object. I object.

The PRESIDING OFFICER. Objection is heard. Under the previous order, there will now be 5 minutes of debate equally divided between the Senator from Texas and the Senator from California.

Mrs. BOXER. Madam President, I ask if Senator HUTCHISON would like to go first?

Mrs. HUTCHISON. Madam President, I prefer to reserve my time and close.

Mrs. BOXER. Madam President, may we have order in the Chamber, please.

The PRESIDING OFFICER. The point is well taken. Senators will take their conversations to the Cloakroom, please.

The Senator from California.

Mrs. BOXER. Madam President, I have taken the Senate's time on this matter. Here is why: I simply care about the Senate too much to see it be a party to a deliberate scheme by just 5 percent of the oil companies to underpay their royalty payments to our constituents. The Hutchison amendment allows the situation to continue by stopping the Interior Department from fixing it.

How do we know taxpayers are being cheated? First, there are many whistleblowers, former oil executives, who say under oath they undervalued the oil from Federal lands in order to pay less.

Second, settlements are occurring all over the country whereby these oil companies are paying billions of dollars in back royalties to keep their cases out of court.

Senator HUTCHISON has said the Interior Department wants to raise taxes on the oil companies. Royalties are not taxes; they are legal agreements just as your mortgage or rent is. As USA Today says:

> Imagine if one day you decided to lower your rent by 10 percent. No individual could do that. And yet the oil companies are.

You may hear all we need is more time, but this is the fourth rider this Senate has passed, although we have never had a vote on it before. This is the first vote. We have already lost $88 million from the Department of the Interior because of it. These companies should do what 95 percent of them are already doing, base their royalty payments on fair market value.

Senator HUTCHISON has said the oil companies are suffering now and it is bad timing to fix this. I voted, and most of us did, for a bill to help the oil companies. That is fine. But royalty payments must be collected and because they are based on fair market value, they do go down when oil prices are depressed. That is a better deal than most Americans get on their mortgages or their rent.

You may hear about a court case in California that the oil companies won. But that had nothing to do with Federal oil royalties; it was about State royalties.

Finally, the Hutchison amendment is not in the House bill because this is an appropriations bill, and the Hutchison amendment will strip another $66 million out of the Land and Water Conservation Fund. We need those funds very much. Senator HUTCHISON says it is just $10 million. Interior and OMB say $66 million. Regardless, it is a bad rider. I hope you will not vote for cloture.

The PRESIDING OFFICER. The time of the Senator has expired. The Senator from Texas.

Mrs. HUTCHISON. I yield 1 minute to the Senator from Louisiana, Mr. BREAUX.

Mr. BREAUX. Madam President, I thank the Senator for yielding. In just 60 seconds, it is unfortunate we are voting with a number of Senators absent. I guess we will have to do that.

The question is, How do we value oil? The law says the companies owe the Federal Government, taxpayers, one-sixth to one-eighth of the value of the oil. The problem is, how do you determine the value? It is a very complicated rulemaking procedure that is ongoing to try to determine what are the legitimate deductions and transportation costs, in particular, determining what the fair market value of oil is. We can rush this thing through. It will result in years of litigation. Or we can pause for a few moments, which is what we are asking to be done, to try to negotiate out something to which both sides can agree. I think it makes more sense to pause for a few moments, get the groups together and work it out, rather than run the risk of years and years of litigation. We know what is going to happen then. Nobody is going to win. The American public is not going to win.

I urge we support the Hutchison amendment and get it done in a more realistic and fair fashion.

Mrs. HUTCHISON. I yield 30 seconds to the Senator from New Mexico.

The PRESIDING OFFICER. The Senator from New Mexico.

Mr. DOMENICI. I rise in support of the Hutchison-Domenici amendment because the MMS's procedures are flawed. Department of the Interior employees involved in the writing of the regulations received $300,000 each from a group that had interests contrary to those of the oil and gas firms.

It is wrong on substance. I will just give one example showing it is flawed. A producer from one oil well producing one kind of oil would be forced to value his oil ten different ways under this MMS proposal.

Mr. MURKOWSKI. Mr. President. I strongly support Senator HUTCHISON's amendment to keep the Department of Interior from spending additional money for one year to implement their flawed oil valuation regulation. I am a cosponsor of the amendment.

Our amendment does two things: First, it puts the Senate on record opposing a Value-added Tax proposed by the executive branch. Second, it prevents MMS from implementing a rule that is so corrupt the Interior Department's inspector general and the Department of Justice are currently investigating $700,000 in payoffs to federal employees involved in the rule.

The CBO scored the impact of this amendment at $11 million. This is the apparent cost of standing up for Congress' constitutional prerogative to raise revenues.

The domestic oil and gas industry is being driven from our shores. During the oil embargo in 1973, we imported 36 percent of our oil. Today, we import 56 percent of our oil. We will continue to burn oil—in fact, we burn a bit more now than we did in 1973. But our own industry is in a death spiral, caused in part by government actions like this. Over 50,000 American families have lost their jobs in the last two years as companies leave the U.S. for foreign shores—foreign shores where it's cheaper to drill and governments encourage domestic energy production.

Without adoption of the Hutchison amendment, we will be saying: "Go ahead. Raise royalties and taxes. We, the U.S. Senate, yield our power to the Executive." This Senator cannot stand by and watch all power flow to the Executive.

"RENT-A-RULE"—POGO, ETC.

Neither can this Senator stand aside when there are serious allegations of payoffs to government employees involved in the rule.

In May of this year, the press began to report that two federal employees—one at the Department of Interior; the other, retired from the Department of energy—had taken $700,000 from a self-described "public interest group" as an "award" for their work in the federal government on the rule to raise royalty rates on domestic oil producers. This group, the project on Government Oversight, or POGO, has not been very effective in its membership drive—it has only about 200 subscribers—but it has been very successful attracting trial lawyers as board members. In fact, the trial lawyers on its board have spent years litigating the very cases on oil value that the proposed DOI rule would benefit if the Boxer Amendment is adopted.

The inspector general and the U.S. Department of Justice public Integrity Section are investigating these payments.

In two letters to the Secretary of Interior, Senators DOMENICI, NICKLES, and I have asked the Department to withdraw the proposed rule pending the outcome of the investigations into whether the employees can take money for "fixing" a rule. The Department has declined to do so twice.

In answering our first letter, DOI said the two had nothing to do with the rule. Senators DOMENICI, NICKLES, and I wrote back, this time providing public documents proving their involvement, and asking them, based upon the evidence, to withdraw the rule.

The response to our second letter was to acknowledge that the two apparently did have some involvement in the rule, but the decision to change the rule was made prior to their official involvement.

The Department's argument is misleading. The two federal employees worked hand-in-glove with POGO to convince the Department to craft a rule to POGO's liking. According to POGO's Executive Director, POGO even arranged for the employees to be specifically requested to testify before a House subcommittee to put pressure on the Department to start a rulemaking.

All the facts suggest that these employees were influential, if not instrumental, in the decision to issue the rule and the content of the rule. After influencing the decision to issue the rule, the employees took part in the public comment phase of the rulemaking. In other words, they were up to their elbows in this issue from start to finish.

A skeptic could conclude that the employees, working with POGO and the trial attorneys who stood to gain from out-of-court settlements, earned their "rewards." POGO, after all, admits they paid them $350,000 each. The Department's position appears to be that POGO paid the wrong bureaucrats.

The public integrity of the public rulemaking process is at stake, even if Secretary Babbitt fails to see it.

In our nation, federal employees are not paid to push rule changes which benefit one party in a lawsuit. This is a dangerous precedent.

The PRESIDING OFFICER. The Senator from Texas.

Mrs. HUTCHISON. Madam President, we directed the MMS to simplify the oil royalty payments so that companies would know what their fair share is. This is what MMS has come forward with as a simplification.

Companies still do not know what they will owe. They want to pay their fair share. I want them to pay their fair share. Whether they have in the past is not an issue. We are trying to have a fair setting of taxes.

The question is: Who makes tax policy in this country? Is it Congress or is it unelected bureaucrats who are not accountable to the people? We are talking about a 1-year moratorium so that this can be worked out in a way that is acceptable to Congress.

The Senator from California says this only affects 5 percent of the producers. I have a letter from the California Independent Petroleum Association, representing 450 independent oil and gas producers, which says:

It is false to claim that this rulemaking only affects the top 5 percent of all oil producers. It affects every California producer on Federal land.

Madam President, I urge a vote for cloture so we can have a fair up-or-down vote on this amendment so that Congress will set the policy of this country.

The PRESIDING OFFICER. All time has expired. By unanimous consent, the mandatory quorum call has been waived. The question is, Is it the sense of the Senate that debate on amendment No. 1603 to H.R. 2466, the Interior Appropriations bill, shall be brought to a close? The yeas and nays are required under the rule. The clerk will call the roll.

The legislative clerk called the roll.

Mr. NICKLES. I announce that the Senator from Utah (Mr. BENNETT), the Senator from Utah (Mr. HATCH), the Senator from North Carolina (Mr. HELMS), and the Senator from Alabama (Mr. SESSIONS) are necessarily absent.

Mr. REID. I announce that the Senator from Florida (Mr. GRAHAM) is necessarily absent.

The yeas and nays resulted—yeas 55, nays 40, as follows:

[Rollcall Vote No. 271 Leg.]

YEAS—55

Abraham	Fitzgerald	McConnell
Allard	Frist	Murkowski
Ashcroft	Gorton	Nickles
Bingaman	Gramm	Roberts
Bond	Grams	Roth
Breaux	Grassley	Santorum
Brownback	Gregg	Shelby
Bunning	Hagel	Smith (NH)
Burns	Hutchinson	Smith (OR)
Campbell	Hutchison	Snowe
Chafee	Inhofe	Specter
Cochran	Inouye	Stevens
Collins	Jeffords	Thomas
Coverdell	Kyl	Thompson
Craig	Landrieu	Thurmond
Crapo	Lincoln	Voinovich
DeWine	Lugar	Warner
Domenici	Mack	
Enzi	McCain	

NAYS—40

Akaka	Feingold	Mikulski
Baucus	Feinstein	Moynihan
Bayh	Harkin	Murray
Biden	Hollings	Reed
Boxer	Johnson	Reid
Bryan	Kennedy	Robb
Byrd	Kerrey	Rockefeller
Cleland	Kerry	Sarbanes
Conrad	Kohl	Schumer
Daschle	Lautenberg	Torricelli
Dodd	Leahy	Wellstone
Dorgan	Levin	Wyden
Durbin	Lieberman	
Edwards	Lott	

NOT VOTING—5

Bennett	Hatch	Sessions
Graham	Helms	

The PRESIDING OFFICER. On this vote the yeas are 55, the nays 40. Three-fifths of the Senators duly chosen and sworn not having voted in the affirmative, the motion is rejected.

Mrs. BOXER. Mr. President, I move to reconsider the vote.

Mr. LOTT. Mr. President, I enter a motion to reconsider the vote by which the Senate failed to invoke cloture on the pending Hutchison amendment.

The PRESIDING OFFICER. The motion is entered.

ORDER OF PROCEDURE

Mr. LOTT. Mr. President, I ask unanimous consent that the yeas and nays be vitiated on the nomination of Maryanne Trump Barry.

The PRESIDING OFFICER. Without objection, it is so ordered.

Mr. LOTT. I understand the Chair will now put the question on this nomination.

EXECUTIVE SESSION

NOMINATION OF MARYANNE TRUMP BARRY, OF NEW JERSEY, TO BE U.S. CIRCUIT JUDGE FOR THE THIRD CIRCUIT

The PRESIDING OFFICER. The Senate will now proceed to executive session to consider Executive Calendar No. 210, which the clerk will report.

THE JUDICIARY

The legislative clerk read the nomination of Maryanne Trump Barry, of New Jersey, to be United States Circuit Judge for the Third Circuit.

Mr. LOTT. Mr. President, I also indicate that we will be prepared to confirm two further judicial nominations by consent before we close business this evening. Therefore, there will be no further votes this evening, and the next vote will occur at 10:30 a.m. on Tuesday in relation to the Bryan forestry amendment.

Mr. LEAHY. Mr. President, the confirmation of Maryanne Trump Barry to the Third Circuit—and I predict that she will be confirmed—will bring to 15 the total number of federal judges considered by the Senate all year.

While I am appreciative of this opportunity to consider this nomination, I note that the Republican leadership has chosen to skip over the nominations of Marsha Berzon, Judge Richard Paez, and Ray Fisher to the Ninth Circuit. These nominations have all been on the Senate calender for as long or longer than that of Ms. Barry. The Republican leadership has, again, skipped over the nomination of Justice Ronnie White for the federal court in Missouri, as well.

All of these nominations could and should have been considered before the August recess. Indeed the nominations of Judge Paez and Justice White, should have been considered when they were first reported last year.

Mr. LAUTENBERG. Mr. President, I rise in strong support of the nomination of Maryanne Trump Barry to the United States Court of Appeals of the Third Circuit.

I commend Senator HATCH for moving forward with this nomination. We must ensure that the federal bench is at full strength so that our citizens will receive justice promptly and fairly. The distinguished chairman of the Judiciary Committee deserves thanks from all who believe that our court system is at the core of our precious democratic structure.

5

more time and effort this is going to be for folks who are still hurting from last year's devastatingly low crude oil prices.

I think we owe that opportunity to our Nation's oil producers, so I am proud to join the Senator from Texas and the Senator from New Mexico, and others in standing up for the right of Congress to pass laws that affect the tax burden on our domestic oil industry.

I ask unanimous consent a letter from Wyoming Governor Geringer to Senator HUTCHISON be printed in the RECORD.

There being no objection, the letter was ordered to be printed in the RECORD, as follows:

STATE OF WYOMING,
OFFICE OF THE GOVERNOR,
September 8, 1999.

Hon. KAY BAILEY HUTCHISON,
U.S. Senate,
Washington, DC.

DEAR SENATOR HUTCHISON: I ask for your strong support of the amendment to the Department of Interior Appropriation Bill which would extend the moratorium on Minerals Management Service (MMS) rule making. Wyoming, as the largest stakeholder of federal oil royalty receipts (35%) supports a fair and workable oil valuation rule. However, the current proposed rules contain more uncertainty and will diminish incentives for industry to lease, explore and produce on the immense amount of federal acreage in Wyoming. Such uncertainty will lead to additional administrative, audit and legal activities, which will lead to higher costs for Wyoming producers, causing their products to be less competitive. Higher costs to the MMS are then passed on to Wyoming and other states in the sharing of net receipts. Last year Wyoming's net receipt share along of MMS activity was $1 million.

Wyoming is currently involved in a pilot project with the MMS to take its crude oil royalties in-kind (RIK) rather than in cash. This RIK pilot program has been designed to allow the state and the MMS to reduce administrative costs, eliminate legal disputes and test the various methods of achieving fair market value for our oil. Therefore, the moratorium extension for two more years would allow such valuable experience to be tested. Allowing a sufficient amount of time to finish the pilot will assist in the development of new rules. Let us keep working cooperatively with MMS, free of this rule making distraction.

While we continue to object to the implementation of Interior's rules, Wyoming has participated in every phase of the rule making process. We also have observed the attempts to craft distracting legislation, which would attempt to address far too many unrelated aspects of the relationship between MMS, stakeholder states and industry. We do not support such efforts. Following our experience with RIK, we believe that a simple approach establishing a voluntary RIK program for the states, embodied in no more than two pages of legislation, will be all that is necessary. Let us go to work on a simple, but effective bill.

I urge you to support the rulemaking moratorium and encourage the MMS and royalty receiving states to engage in a genuine partnership role which will insure a fair, workable and beneficial plan to collect royalties. Adoption of the proposed rules would obstruct any opportunity to improve our royalty collection process.

Thank you for your support and understanding!

Best regards.

JIM GERINGER,
Governor.

The PRESIDING OFFICER (Mr. BENNETT). The Senator from Alaska is recognized for 5 minutes.

Mr. MURKOWSKI. Mr. President, I thank the Chair. I have listened to the debate with a little frustration, as I am sure my colleagues have, regarding the emotional arguments prevailing on an issue that fails to give disclosure to the public on what this issue is all about.

The Hutchison moratorium amendment keeps the MMS from spending money for 1 year to implement a new rule that amounts to another tax, a value-added tax, on oil produced in the United States on Federal leases. What they don't say in the debate is who pays this additional tax. It is the American consumer, the taxpayer, the public.

Bureaucrats don't have the right to unilaterally establish a tax. That is just what this proposal does. That is a right that is reserved in the Constitution, by the Constitution to this Congress. Existing law says royalties should be collected at the lease, not after value has been added downstream as the rule proposed by Department of Interior would do. This MMS rule, for the first time in history, embraces a value-added tax concept to oil valuation.

There is little mention about the energy security interests of this country. We are now dependent upon imported oil. Imported oil is the No. 1 contributor to our trade deficit. The domestic oil industry is in tough shape. In 1973, during the oil embargo, we imported 36 percent of our oil. Today, we import 56 percent. The Department of Energy says that figure will go up to the 63- to 64-percent area by the years 2005, 2006, and 2007, and over 55,000 American jobs have been lost in the last 2 years in the oil industry, five times the number in the steel industry. The MMS rule drives U.S. jobs overseas, increases our trade deficit, and makes America more dependent on one area of the world that is very volatile, the Mideast.

This moratorium by the Senator from Texas has been in place for 2 years. The press has reported two Government employees have been paid $350,000 each from a group associated with the trial lawyers as an award for pushing for the new rule which benefits—benefits whom? It doesn't benefit the taxpayer or the consumer; it benefits the lawyers. The Department of the Interior inspector general and Justice Department are investigating. Something is rotten around here. It is not in Denmark. It has something to do with the process.

This has the effect of turning our Government regulation over to the highest bidder. No rule tainted by payoffs to the rulemakers should be tolerated. It is interesting to note, as the Senator from Texas has, they say they want to simpl
today reminds
SPECTER pros
scribing the s
had been pro
and the admi
this chart. If
on the workal
proposes a va
termining th
oil. you and
hold water.

This is a cancer within Government. We talk about whistleblowers and those who are supporting the proposed MMS gasoline and heating oil tax which Senator HUTCHISON's amendment postpones for 1 year. When they think about a whistleblower, most people think of something someone sees is wrong, who blows a whistle to draw attention. The Federal Government has laws on the books to protect whistleblowers who come forward to report fraud and abuse.

Let's look at this case. This case is a little different. Two Federal employees, one working for the Department of the Interior and the other working for the Department of Energy—the two Departments of jurisdiction; these are supposed to be objective people—worked behind the scenes and pushed for the MMS rule change. They were paid $350,000 each on September 18, 1999 as rewards for their work. There is a copy of the check.

The point of this is, they were paid by a self-described public interest group which has about 200 members. This group, the Project On Government Oversight, or POGO, has rather curious ties to law firms which have made millions of dollars from suing oil companies over oil royalties. Make no mistake about who pays: The public.

As an example, POGO's board of directors has included lawyers who have worked directly on these cases for years. The City of Long Beach, CA, lost the most recent case. An attorney for the city said they spent about $100 million on the case. That is $100 million that could have been spent on education and was spent on lawyers instead.

The Department of the Interior is investigating, but it is illegal for Federal employees to be paid for pursuing changes to Federal regulations by those who benefit from such changes. Our Secretary of the Interior, what has he done? He has done nothing. The Interior Department had nothing to do with it.

The Hutchison amendment should be adopted to give time to work on a fair and simple regulation to States, Federal lessees, and taxpayers.

That chart is not a simplification. I commend my colleague for her effort to expose the truth behind the fiction we have heard so much about today.

I yield the floor.

The PRESIDING OFFICER. The Senator from Texas.

Mrs. HUTCHISON. Mr. President, I thank the Senator from Alaska, the

0113 7080 114 1
PROJECT ON GOV OVERSIGHT INC.

1099

November 2 1998

PAY TO THE ORDER OF Robert A. Berman $ 383,600.00

Three Hundred Eighty-three Thousand Six Hundred Dollars and No Cents*** DOLLARS

MINIMUM AMOUNT $100.00

FOR Public Service Award

1099 01

DR 00010425

PROJECT ON GOV OVERSIGHT INC

1100

November 2 1998

PAY TO THE ORDER OF Robert A. Speir $ $383,600.00

Three Hundred Eighty-Three Thousand Six Hundred Dollars and No Cents*** DOLLARS

MINIMUM AMOUNT $100.00

FOR Public Service Award

Keith Rutter

DB 00010423

January 5, 1998

This is to put in writing the standing oral agreement between the Project On Government Oversight (POGO), Mr. Robert Speir and Mr. Robert Berman concerning our False Claims Act suit regarding the underpayment of royalties by oil companies to the federal government. Any and all proceeds to come to the Project On Government Oversight or Danielle Brian through this law suit will be shared equally (33 1/3%) between POGO, Mr. Speir and Mr. Berman.

Signed:

Danielle Brian

Danielle Brian
Project On Government Oversight

Robert Speir 1/5/98
Bob Speir

Robert Berman 1/5/98
Bob Berman

Department of Energy
Washington, DC 20585

November 30, 1995

MEMORANDUM FOR: Dave Hubbard **BY FAX**
Chief, Economic Valuation Branch
Royalty Management
Minerals Management Service
Denver, Colorado

FROM: Robert A. Speir
Office of Oil Policy
Department of Energy

SUBJECT: Unpaid Royalty Collection Option Paper

Dave,

I am writing this partly because I will be occupied for most of today and tomorrow with other projects, and partly because I want to be clear about my views on the option paper. As you expect, I was somewhat amazed by your phone message stating that Cynthia Quarterman directed that we substantially abbreviate what we have been drafting for next week's decision meeting. According to your message, her main concern is preventing disclosure of our findings under the FOIA. But the records (drafts of the options paper, collectability estimates, etc.) have already been created and would be available for consideration under FOIA. Either you will, or will not release these documents if you get a FOIA request; the same goes for a decision paper.

The only logic I can put to this is that Ms. Quarterman wants deniability. That is, she wants to be able to say that she and other management never saw what we created. Frankly, if that is the reaso[illegible] not hold water. If asked, she would have to say she sa[illegible] decision meeting where we discussed these issues and displ[illegible]arts that showed what we found. Further, the fact that she h[illegible]rected our writing indicates that someone took up the optio[illegible] subject with her prior to today and she elected to change [illegible] document. After Mo Gonzales' emotional demand to eliminate the paper in our telecon Tuesday, and his direction to Howard Chalker to make sure Peter Schaumberg reviews it, it is not hard to imagine what trail the paper took to Ms. Quarterman.

Printed with soy ink on recycled paper

Yes, I am sorry to see this happen because we both have wasted a lot of time on this paper, and I think it would have been a good one. Worse yet, the fact that DOI seems to be attempting to pull down the shades on this issue indicates that the fix may be in again as in 1986 and as with your paper a couple of years ago.

cc: Burnaby Huber, DOJ
Len Coburn, DOE
Bernie Kritzer, DOC
Howard Chalker, DOI
Walt Rosenbush, DOI
Lee Helfrich, Lobel Novins

FRONTIERS OF FREEDOM

1401 WILSON BLVD., 10TH FLOOR, ARLINGTON, VIRGINIA 22209

Sen Malcolm Wallop (ret.)
Chairman

FACSIMILE TRANSMITTAL

To: **David S. Guzy** Fax: 303-231-3385
Minerals Management Service

From: George C. Landrith Phone: 703-527-8282, Ext. 105
Executive Director Fax: 703-527-8388

Date: January 31, 2000 Total No. of Pages (including cover sheet): 118

This facsimile may contain confidential and legally protected information belonging to the sender, and is intended only for the use of the recipient noted above. If you are not the intended recipient, please contact us by telephone and destroy all information. If there are problems with this fax, or if you do not receive all pages indicated herein, please call 703-527-8282.

_____ Original WILL follow by: _____ Original WILL NOT follow.

_____ Regular Mail _X_ Overnight Mail

_____ Hand Delivery _____ Other ___________

Given the length of this fax, we will send it in several installments each preceeded by this cover page. Therefore, the total number of pages will add up to the above number (minus the repeated cover page).

Final Interagency Report on the Valuation of Oil Produced from Federal Leases in California

May 16, 1996

Prepared for the Assistant Secretary - Land and Minerals Management and the Director of the Minerals Management Service, United States Department of the Interior *to go back at least to 1984, the recommended approach for Shell, which it audited for 1984, is similar to that for Texaco.*

For the period before March 1, 1988:

- *The Commerce and Energy Department representatives recommend using adjusted Alaska North Slope oil market prices as the basis for valuing Federal crude oil in California for royalty purposes. They recommend pursuing royalty underpayments from 1980 forward.*

- *The MMS/Solicitor's Office representatives recommend applying the same procedures as used for the post-March 1, 1988 period for pursuing royalty underpayments. They also recommend that MMS management, in consultation with the Solicitor's Office and the Justice Department, make the decision about how far back to pursue royalty underpayments.*

The team recommends that MMS' oil royalty valuation regulations be revised to consider alternatives to reliance on posted prices and to modify a number of definitions and instructions that may hamper royalty collection.

I. EXECUTIVE SUMMARY

Events Leading to Team Formation

The issue of whether major California oil companies underpaid royalties on crude oil by basing those royalties on unreasonably low posted prices[1] goes back many years. The State of California (State) and the City of Long Beach (City), in very lengthy litigation against seven major integrated oil companies operating in California, obtained an extensive body of company documents covering the 1970's and 1980's. *Long Beach* documents show that major oil companies often bought and sold crude oil at premiums over posted prices.

In 1986, the Minerals Management Service (MMS) reviewed the California oil undervaluation matter with State officials and concluded that posted prices fairly represented royalty value. However, by 1991, ARCO, Shell, Chevron, Mobil, Texaco and Unocal settled for approximately $345 million (of which $320 million was in cash) to end the actions alleging undervaluation on State and City leases. Dollar amounts cannot be tied to specific findings,

---

[1] Traditionally, oil posted prices represented prices oil purchasers were willing to pay for particular crude oils in specific areas. Since they often provided the basis for arm's-length purchases and sales, they generally were considered to be representative of market value. But in recent years, posted prices have been increasingly criticized in a number of States as not being representative of the true market value of crude oil.

and issues other than valuation were involved.

In late 1993, in light of these settlements, MMS roughly estimated the size of any potential Federal royalty underpayments and decided the amounts warranted further analysis. The MMS Director consulted with State officials; they agreed that MMS should seek input from other agencies and the State would assist in gaining access to the company documents under court seal.

Interagency Team Formation and Composition

In June 1994, the Department of the Interior (Department) formed an interagency team (team). It included one member each from the Department of Energy, the Department of Commerce, the Department of Justice's Antitrust Division, and the Department's Solicitor's Office, and two MMS employees. Various individuals have represented the State at many of the team's meetings.

Review of MMS Royalty Valuation Regulations

The team reviewed MMS' royalty valuation regulations because a determination of the adequacy of Federal California royalty payments must be made under these regulations. MMS revised its royalty valuation regulations on March 1, 1988. Prior to 1988, MMS' royalty valuation regulations were almost identical to Federal lease terms. Neither these regulations nor the lease terms provide separate directives for valuation under arm's-length and non-arm's-length contracts. Both these regulations and the lease terms set gross proceeds as minimum royalty value. When MMS revised its regulations in 1988, it added specific guidance for valuing oil not sold under arm's-length contracts.

MMS set benchmarks that direct MMS to rely on arm's-length contracts for sales and purchases of oil produced from the same field or area as the oil being valued. This is particularly relevant in California, because most oil produced by integrated oil companies is not sold at arm's-length. The revised regulations maintained the principle that gross proceeds are minimum value for oil sold under both non-arm's-length and arm's-length contracts.

Review of Oil Company Records Under Court Seal

The Departments of Commerce, Energy and Interior (Departments) and eight major oil companies drafted a confidentiality agreement enabling the team to review the records under court seal. These documents showed that the major California oil companies often sold, purchased and valued (for non-royalty purposes) crude oil at premiums over posted prices.

Team Recommends Test Audits

After its first examination of selected court-sealed documents, the team recommended that MMS examine records for one or more oil companies. MMS was to determine if premia over posted prices were paid for Federal oil, and if such premia existed, to determine if Federal royalties reflected these premia. These audits were to review the lessee's gross proceeds based on the first arm's-length sale by the producing company or its affiliate. MMS audited Texaco's records for 1989 and 1993 and Shell's for 1984. The audits confirmed the presence of premia over postings in both Texaco and Shell transactions.

regulations rely on prices paid or offered in the same field or area as the lessee's production, and royalty is not to be less than gross proceeds accruing to the lessee from the sale of its production.

The following sections amplify these positions.

2) **Establishing Royalty Underpayments Employing ANS Crude Oil--Recommendation by the Energy and Commerce Department Representatives**

Throughout the 1980's, evidence mounted[25] that posted prices, particularly in California, were substantially lower than the true value of the oil. Lawsuits by the State of California and the City of Long Beach uncovered a wealth of company documents that showed companies routinely bought and sold California crude oil at prices substantially over posted prices. The records the team reviewed, as discussed in the "Findings" section of this report and Appendix 4, show that they justified those actions with internal analyses demonstrating that, even at premia of several dollars per barrel over posting, California crude oil was still undervalued. The standard usually used in the records reviewed was quality-adjusted prices or values for Alaskan North Slope crude oil--one of the few competitively-traded crude oils

[25]MMS feels evidence existed during the 1980's to indicate that posted prices were an acceptable measure of oil value. Studies by A.D. Little Inc. and the General Accounting Office did not find that posted prices undervalued oil in California. Also, the Department of Justice declined to pursue antitrust actions against the defendants in the Long Beach litigation.

in the State.[26] During the period under review ANS crude oil accounted for approximately 30 to 45 percent of the crude oil refined in California.

The team's Energy and Commerce Department representatives recommend establishing the value of California crude oil based on quality-and transportation-adjusted open-market prices of ANS oil. This ANS valuation is the open-market price paid in the geographical proximity to the locations where a major portion of California crude oil is refined. Adjustments for relative quality differences between ANS and California crude oils would be made using factors employed by the industry at the time.

(a) Authority Under MMS Regulations

In the opinion of the team's Energy and Commerce Department representatives, prior to 1988, the MMS royalty valuation regulations were substantially more flexible than are the current regulations. In fact, the 1988 regulations, which were the result of several years of discussion between the Federal and state governments, industry and others, were in part a response to perceived subjectivity in interpretation. Therefore, the Energy and Commerce representatives believe that the regulations that were in effect at the time permit the MMS to value California crude oil just as the Long Beach suit records show that oil companies themselves established value.

[26] By 1984, Line 63 mix, a blend of San Joaquin Valley heavy and light crudes, was also traded enough to justify publishing a "spot" price in several industry trade publications.

The regulatory authority for this position derives from 30 CFR § 206.103, which begins:

> The value of production, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the Associate Director... (emphasis added)

The section continues, observing that "due consideration" should be given to highest prices paid, prices received by the lessee, and posted prices. Latitude was allowed to include "other relevant matters." The regulation quite clearly establishes the gross proceeds to the lessee from a royalty oil sale as only the lower limit on valuation.

The pre-1988 regulations did not contain a complex benchmark system for valuing oil not sold at arm's-length. Rather, they included qualified direction on the use of sales prices for valuation. Specifically, for onshore leases, the regulations state:

> In the absence of good reason to the contrary, value computed on the basis of the highest price... paid or offered at the time of production in a fair and open market for the major portion of like-quality oil...produced and sold from the field or area where the leased lands are situated will be considered to be a reasonable value. (30 CFR §206.103 (1986)[27]

---

[27]Identical language is contained in outer continental shelf leases. The terms "sold" and "major portion" are not defined, thereby lending a degree of subjectivity to interpretation and application of the regulation.

This infers that, at a minimum, value should be established by arm's-length[28] sales records.

The team's investigations, and the observations of MMS' consultants, indicate that the amount of California crude oil purchased or sold under arms-length contracts was relatively small. On the other hand, hundreds of thousands of barrels per day of ANS crude oil were sold in California by ANS producers--principally Sohio/British Petroleum, which did not have a California refinery. Further, although California crude oil quality varies over a large range of API gravities, California refiners found ANS crude sufficiently similar to permit using simple price adjustments (e.g., figures of $0.15-$0.20 per API degree) to establish a relative value for the local crude oils.

It follows that the "open market" standard for California crude oil value was (and still is) Alaskan North Slope crude oil sold in the Los Angeles and San Francisco markets. The applicability of this observation to California royalty values might be hard to establish were it not for the fact that the Long Beach records show that refiners (who were also Federal crude producers) routinely valued incremental purchases of California crude oil in this manner. This, in and of itself, constitutes the "good reason to the contrary..." to forego valuation using purchase and sales contracts in favor of establishing California royalty value based on ANS crude oil sales.

[28]Although the regulation does not specifically mention arms-length purchases and sales, intra-corporate transfers certainly do not qualify as "open market" activity.

initiating collection from 1980 forward, while the MMS/SOL representatives believe the team should not make a specific recommendation on this issue. Their respective rationales follow.

2) Rationale of DOE/Commerce representatives

Crude oil undervaluation in California is a decades-old problem. This study documented a pattern of royalty underpayment occurring over a span of years for the two companies MMS audited, and provided strong evidence that the practice extended to most major oil companies in the State. With the evidence of underpayment so clear, the Federal Government should attempt to collect the majority of the amount it is owed. Consistent with this philosophy, the representatives from the Energy and Commerce Departments recommend pursuing collections of unpaid royalties and interest from 1980 forward.

Beginning with 1980 covers the period when the largest underpayment took place. Analysis supporting the team's December 1995 Option Paper for Interior Department management showed that, of the potentially recoverable royalties and interest attributable to undervaluation during 1978-93, 63 to 74 percent is associated with the 1980-85 period. Restriction of the collection period to the years after 1985 would address only one-sixth to one-third of the unpaid royalty and interest estimate for 1978-93.

During its study, the team received a number of briefings on legal matters pertaining to the effect of the statute of limitations on collecting previously owed Federal royalties. Due to differing court decisions on the matter, the situation is, at best, unresolved. However, the Department of Interior's position, both in public and in court, is that the statute of limitations does not apply to these matters. Therefore, any policy decision based solely on statute of limitations considerations, thus limiting collections to a small part of what might be recoverable, is not consistent with the Department's position, and may not be required by the courts.

Choice of 1980 as the most distant year of collection is not arbitrary. There are two reasons for this cutoff date:

- First, and most important, crude oil prices were Federally controlled prior to 1980, making the case for collecting royalties based on crude oil undervaluation much more difficult.[36]

- Second, the amount of revenue that might be collected for each year preceding 1980 is relatively small due to low crude oil prices and royalty volumes. Adding 1978 and 1979 to the collection period, for example, would

[36]The State of California in its Long Beach case pursued collections from the companies dating back to 1971 with litigation beginning in 1975. The Department of Interior, in its October 1993 scoping paper, considered potential back royalty payments dating from 1960. Therefore, the choice of 1980 represents a compromise between going back to the late 1960's and limiting the scope of the investigation to post-March 1, 1988.

Note:

TO: Brooks Yeager

FROM: Bob Berman

SUBJECT: California Common Carrier and Crude Valuation

DATE: August 6, 1993

The Court recently found in favor of the State of California and City of Long Beach in the 16-year antitrust suit (see attached article in *Platt's Oil Gram News*). Hence, the analysis in the attached issue papers should be regarded as based on established fact rather than allegation or conjecture. The issue addressed the practices and pricing policies, made possible through practices, inconsistent with the common carrier requirement of the right-of-way, that lead to the undervaluation of California crude oils and subsequent denial of the royalties rightfully due the Federal government.

You will recall (see copies of prior issue papers attached) this issue involves BLM and MMS programs. Specifically, BLM grants rights-of-way over Federal lands for oil pipelines on the condition that they be operated as common carriers. MMS collects royalties on oil produced from Federal lands.

I suggest that the Department proceed immediately to ascertain the amount of additional royalties due, including interest and criminal penalties, if any, and initiate collection procedures. This will involve intervening in the on-going litigation to protect Department interests and ensure access to evidence under court protective order. MMS has indicated an interest in pursuing the royalty issues.

The common carrier issues should also be addressed at the same time. This should include (1) an investigation to determine whether rights-of-way agreements were violated; (2) additional clarification or regulations that may be required; and (3) intervention in the State of California's appeal of the decision regarding Mobil and Mobil's interpretation of the Mineral Leasing Act and inappropriate claims that this interpretation is shared by the Government.

To facilitate the above, it is further suggested that you raise the matter the Assistant Secretary Armstrong and Solicitor Leshy; and form a team of representatives of BLM, MMS, SOL and PPA. The team approach is appropriate due ensure proper coordination due to the interrelatedness of the two issues, and to assist in the specialized economic analysis that may be necessary is quantifying the totally of the damages suffered by the Government.

F

California Common Carrier and Crude Valuation

Bureaus: BLM, MMS	States: California

Issue: Should the Department actively pursue the "common carrier" and associated crude oil product value issues in California?

Recommendation: The Department should establish an internal process and investigate (1) whether holders of pipeline rights-of-way across Federal lands are operating such pipelines as common carriers; and (2) whether the system of crude oil trading (badger or 3-Cut exchanges), monopolistic common purchasing and/or failure to provide pipeline access led to an under-valuing of crude oil resulting in deficient royalty collections. In the event the investigation results in a positive finding, the Department should (1) revoke rights-of-way of holders not providing common carriage (and not agreeing to provide such carriage); and (2) initiate action to collect royalties due.

Options:

(1) Pursue both common carrier and royalty issues.

Pro:

1. Recognizes mutual interdependence of the issues.
2. Could provide significant additional revenues.
3. Could benefit independent producers and refiners in California, thus enhancing competition.
4. Secretary would be perceived as taking positive action to resolve a long-standing problem, regardless of outcome. Action would be dispositive of issue.
5. High likelihood of Congressional hearings. Action underway would be perceived favorably.
6. Consistent with State government actions.
7. Action would be favored by independent oil producers and refiners.

Con:

1. Department has never challenged right-of-way holder on common carrier requirement of statute.
2. No regulations have ever been promulgated to address the common carrier issue, or to define a process for reviewing and revoking a right-of-way.
3. Major oil companies could perceive Secretary as being anti-oil.

(2) Pursue only the common carrier issue.

Pro:

1. Could benefit independent producers and refiners in California, thus enhancing competition.
2. Secretary would be perceived as taking positive action to resolve a long-standing problem, regardless of outcome.
3. Some action would be viewed favorably by Congress.
4. Avoids potential embarrassment of second failure on royalty issue.
5. Viewed by the State government as at least "half a loaf" since one objective is to enhance the position of independents *vis-a-vis* integrated firms.
6. Action would be favored by independent oil producers and refiners.

Con:

1. Fails to recognize mutual interdependence of the issues.
2. Forgoes significant additional revenues.
3. Action may not be dispositive of the issues.
4. Viewed by State government as only "half a loaf" since they are very interested in the royalties.
5. Major oil companies could perceive Secretary as being anti oil.

(3) Pursue only the royalty issue.

Pro:

1. Could provide significant additional revenues.
2. Some action would be viewed favorably by Congress.
3. Viewed by State government as at least "half a loaf" since they are very interested in the royalties, and have been requesting Department assistance for some time.

Con:

1. Failure to include common carrier issue would weaken royalty claim.
2. Action would not be dispositive of the issue.
3. No benefits to independent producers or refiners, or to competition in California.
4. May be viewed by the State government as only "half a loaf" since one objective is to enhance the position of independents *vis-a-vis* integrated firms.
5. Major oil companies could perceive Secretary as being anti-oil.

(4) Take no action.

Pro:

1. Largely consistent with Department position for last several years.

2. Option would be favored by major oil companies.
3. Avoids any potential embarrassment that might be associated with failure.

Con:

1. Forgoes significant additional revenue.
2. Congress would likely be critical of lack of action given the materials provided by the State of California.
3. State government would view non-action unfavorably.
4. No benefits to independent producers or refiners, or to competition in California.

Initial Review: An initial examination of testimony and evidence developed in connection with the *California v. Chevron, Mobil, Texaco, et. al.* litigation (hereafter referred to as the Long Beach II or LB-II litigation) appears to provide reason to suspect that certain rights-of-way holders may have improperly certified as to their common carrier status as required by Section 28 of the MLA. Moreover, the evidence further appears to provide reason to suspect that such failure to satisfy MLA common carrier obligations, in conjunction with other practices, has led to a significant under-pricing of crude oil in California. Some of this crude oil was extracted from Federal lands; and some of this was subject to Federal royalty payments. Accordingly, any under-pricing would result in valuation below fair market value and subsequent underpayment of royalty obligations. Much of the evidence developed in the LB-II litigation has not been previously available to the Department.

Congressional Interest: Congressman Philip Sharp has recently learned that some of this evidence, including evidence that may be the subject of a California Court protective order, was inadvertently provided to the Department of Commerce as part of an environmental assessment they were conducting concerning allowing the export of California heavy crudes. Congressman Sharp has communicated his interest to Secretary Brown, requesting "copies of all records relating to the operation of oil pipelines in California obtained by the Department of Commerce in the past 12 months."

Congressman Sharp has had a long-standing interest and concern in this area, and had inquired about Department knowledge such practices in the past. It is, therefore, reasonable to assume that the Congressman may wish to discuss these matters with the Department of the Interior in the near future.

Background: Section 28 of the MLA requires that all pipelines granted rights-of-way over Federal lands be operated as a common carrier. Although no definition of a common carrier is contained in either the statute or in Department regulations implementing the statute

[1], a common law definition (Black's Law Dictionary) states "Common carriers are those that hold themselves out to undertake to carry persons or goods indifferently, or of all who choose to employ it." The legislative history revels that there was concern that the only pipelines were those operated by the integrated oil companies; and, accordingly, Congress required that any oil pipelines crossing lands subject to the MLA be operated as a common carrier so that "these [independent] producers reach the market which otherwise they could never reach." The legislative history specifically identifies pipelines owned by Associated Oil and Standard Oil, and voiced the concern that "They were not common carriers; they would not take the oil of anybody <u>unless that person sold it to them at their own price</u>."[2][Emphasis added.] Section 28 of the MLA was intended to solve that problem.

In 1935, Interior Secretary Ickes expressed additional concern, and supported an amendment that, *in addition* to requiring common carriage, also included a requirement to "...accept, convey, transport, and/or purchase without discrimination...in such proportionate amounts as the Secretary of the Interior may determine to be reasonable",[3] expanding the scope of Section 28. That this 1935 amendment was intended to expand the scope of Section 28 is further demonstrated in Interior Secretary Whitaker's 1973 letter to Senator Jackson: "...The amendment was enacted not to enforce the common carrier provision, but to prevent harm to the public lands and mineral resources of the United States...."[4]

Certain integrated oil companies, by contrast, have long asserted that the effect of the 1935 amendment was to limit the common carrier provision and allow the common carriage requirement to be fulfilled by non-discriminatory purchasing

---

[1] The Solicitor's office is currently preparing a memorandum addressing BLM's legal questions relative to the common carrier issue.

[2] H-16 at 2.

[3] H-11 at 2.

[4] H-6 at 10.

(e.g., the price it paid to others when purchasing).[5] They have further asserted Department of the Interior agreement in this interpretation by quoting the Department as finding that "Arm's length purchases and exchanges satisfy the MLA requirement of purchasing without discrimination."[6] However, the same correspondence also stated, "As to pipelines refusing to transport oil of another owner, no specific occurrence has been identified."[7] The written refusals to transport oil of another owner which surfaced in the LB-II litigation[8] appear to provide basis for reconsideration.

Although the BLM has not received any documented complaints[9], correspondence between independent producers and integrated oil companies concerning requests for common carriage through pipelines holding rights-of-way pursuant to the MLA is consistently denied. The pipeline companies consistently and unequivocally state that the pipelines are private facilities which transport only their own oil.[10] Indeed, the companies themselves have stated that "Getty and Texaco have always operated

---

[5] H-2 at 62. H-5 at 25-27. H-7 at 7. H-8 at 20. H-9 at 18.

[6] H-2 at 64. H-7 at 8. Reference is to a memorandum from Assistant Secretary, Land and Minerals Management, to Secretary of the Interior (February 17, 1987); and letter from James M. Hughes, Deputy Assistant Secretary, Land and Minerals Management, to Representative Philip R. Sharp (April 19, 1990).

[7] Letter from James M. Hughes, Deputy Assistant Secretary, Land and Minerals Management, to Representative Philip R. Sharp (April 19, 1990).

[8] H-12, H-14, and H-15.

[9] Burton J. Stanley in the Office of the Regional Solicitor, Pacific Southwest Region, in commenting on 1991 IG finding of lack of compliance, explained the lack of complaints as follows: "The problem arises because there is no state or federal agency capable of assuming regulatory jurisdiction over these pipeline companies. An independent oil producer is indeed unlikely to challenge the operation of a pipeline company in a proprietary manner if, in fact, he can obtain no meaningful relief even if he complained." [Memorandum BLM PS.1308 dated January 14, 1990, contained in IG audit report no. 91-I-503 dated February 1991.]

[10] H-15. H-14.

its line privately and have never carried oil for others for compensation."[11]

Separately, and independently of the common carrier issue, the MMS has unsuccessfully pursued the under-pricing / royalty valuation issue in California. The basis of prior allegations has been limited to the inconsistency between (1) posted prices and prices implied by refinery net-back analyses, and (2) gravity differentials in the California market relative to the mid-continent market. The LB-II litigation appears to offer a more compelling argument by explaining the under-pricing through linkage to the common carrier issue and other price, exchange, and purchasing practices of the integrated firms in California.

From an economic perspective, a vertically integrated firm possessing strong market or monopoly power cannot be presumed to behave as a common carrier by acting as a common purchaser; even if it stands ready to purchase all oil tendered at its offering price. That is because such a firm can exercise its market power by offering only very low prices and / or exchanging only with large location differentials. This was precisely the concern that led to section 28 in the first place.[12]

That the effect of continuing to serve only as a common purchaser has resulted in field prices significantly below fair market value is freely admitted by the integrated companies[13]; and is attested to by the difference in their practices when dealing with each other. That is, records of integrated oil companies show that they believed that the prices paid for heavy crudes, in particular, were "less than true value".[14] It is specifically this under-pricing that led to the development of the 3-Cut

---

[11] H-2 at 50.

[12] The legislative history shows that pipeline companies were behaving as common purchasers for many years prior to the MLA. It this practice were acceptable to the Congress, there would have been no reason to include section 28 at all. Indeed, the nature of the problem then, as now, is that pipeline companies act *only* as common purchasers and, by not providing to common carriage, enforce their low field price objective.

[13] B-1 at 13-26.

[14] B-1 at 13-15.

exchange.[15] Court records show, for example, a Texaco official explained the need for the 3-Cut exchange as:

> Generally speaking badger [3-Cut] exchanges are considered to be the most equitable arrangement for both parties and, in many instances, posted price or gravity barrel exchanges are very adverse economically to one of the parties to the exchange.[16]

Similarly, on deposition, ARCO's Crude Supply Manager characterized the 3-Cut:

> Q. The question I am asking you is simply, do you agree that 3-cut exchanges were utilized in California because crude oils were not priced according to their value in California?...THE WITNESS: If you are looking for a simple answer, yes.[17]

It is further important to note that the 3-cut exchanges were not "a wash", but produced very large imbalances, whether measured in barrels or dollars. The

---

[15] In simple terms, the 3-Cut exchange was a mechanism allowing crude to be exchanged a cut at a time, as if it were refined product. This allowed for pricing consistent with the crudes actual market value, rather than the posted price. This exchange basis (later giving way to gravity balancing exchanges) was used by the integrated oil companies when dealing among themselves; since valuation at posted prices would severely disadvantage one of the parties, and therefore not acceptable. Posted prices (or location discounts from posted prices) were used only for dealing with independent producers (and valuation of crude for royalty purposes). Although it is easiest to understand the operation of the 3-Cut exchanges involving pipeline transportation (and the majority did appear to involve pipelines), such exchanges were used even when pipeline transportation was not involved, as when deliveries were by tanker. Although it is claimed that 3-Cut exchanges were used only ease the refiner's burden of adding and subtracting exchanged crudes without protracted negotiations, as well as providing a means for automatic maintenance of a quality balance, it is important to recognize that 3-Cut exchanges were never used outside the California market.

[16] B-1 at 14.

[17] B-1 at 16.

persistence of the large imbalances necessitated periodic settlements between the exchanging parties to reduce the imbalances.[18] Since such payments were the result of exchange sales, they should be viewed as a part of the payment for the crude, even though such payment may have occurred outside the sale contract itself. To the extent that such payments were related to the sale or exchange of crudes lifted from Federal leases (including those crudes exchanged for similar, non-Federal crudes before reaching their final destination), they are properly royalty bearing.

There are also reported to be other indicia of significant under-pricing of California crudes, including quantitative analyses indicating that the amount of such under-pricing may have been as high as $2 - $4 per barrel. These include comparison of posted prices with:

- o Comparable ANS crudes;
- o Crudes sold at auction, including Federal auction sales; and
- o Prices obtained from traders.[19]

[18] B-1 at 19.

[19] Much of the economic analyses is currently under protective order. Its existence and results are reported based on discussions with the individual who conducted the analysis.

Oil Pipeline Rights-of-Way And Royalty Valuation of Oil In California

Bureaus: BLM / MMS	States: California

Issue: Have oil pipelines failed to operate as common carriers, contrary to their certification and requirements of the Mineral Leasing Act of 1920 as amended (MLA)? Has such failure led to under-pricing of crude from Federal lands, thus denying the Government proper royalties?

Recommendation: The Office of Policy Analysis should co-ordinate and substantively participate in a study of the common carrier issue and the royalty valuation issue with the BLM and MMS (initial discussions with BLM and MMS staff indicate favorable disposition). To facilitate this, additional information should be sought and obtained as soon as possible, including information which may be under protective order issued by the California State Court.

Initial Review: An initial examination of testimony and evidence developed in connection with the *California v. Chevron, Mobil, Texaco, et. al.* litigation (hereafter referred to as the Long Beach II or LB-II litigation) appears to provide reason to suspect that certain rights-of-way holders may have improperly certified as to their common carrier status as required by Section 28 of the MLA. Moreover, the evidence further appears to provide reason to suspect that such failure to satisfy MLA common carrier obligations, in conjunction with other practices, has led to a significant under-pricing of crude oil in California. Some of this crude oil was extracted from Federal lands; and some of this was subject to Federal royalty payments. Accordingly, any under-pricing would result in valuation below fair market value and subsequent underpayment of royalty obligations. Much of the evidence developed in the LB-II litigation has not been previously available to the Department.

Congressional Interest: Congressman Philip Sharp has recently learned that some of this evidence, including evidence that may be the subject of a California Court protective order, was inadvertently provided to the Department of Commerce as part of an environmental assessment they were conducting concerning allowing the export of California heavy crudes. Congressman Sharp has communicated his interest to Secretary Brown, requesting "copies of all records relating to the operation of oil pipelines in California obtained by the Department of Commerce in the past 12 months."

Congressman Sharp has had a long-standing interest and concern in this area, and had inquired about Department knowledge such practices in the past. It is, therefore, reasonable to assume that the Congressman may wish to discuss these matters with the Department of the Interior in the near future.

Background: Section 28 of the MLA requires that all pipelines granted rights-of-way over Federal lands be operated as a common carrier. Although no definition of a common carrier is contained in either the statute or in Department regulations implementing the statute

[1], a common law definition (Black's Law Dictionary) states "Common carriers are those that hold themselves out to undertake to carry persons or goods indifferently, or of all who choose to employ it." The legislative history revels that there was concern that the only pipelines were those operated by the integrated oil companies; and, accordingly, Congress required that any oil pipelines crossing lands subject to the MLA be operated as a common carrier so that "these [independent] producers reach the market which otherwise they could never reach." The legislative history specifically identifies pipelines owned by Associated Oil and Standard Oil, and voiced the concern that "They were not common carriers; they would not take the oil of anybody unless that person sold it to them at their own price."[2][Emphasis added.] Section 28 of the MLA was intended to solve that problem.

In 1935, Interior Secretary Ickes expressed additional concern, and supported an amendment that, *in addition* to requiring common carriage, also included a requirement to "...accept, convey, transport, and/or purchase without discrimination...in such proportionate amounts as the Secretary of the Interior may determine to be reasonable",[3] expanding the scope of Section 28. That this 1935 amendment was intended to expand the scope of Section 28 is further demonstrated in Interior Secretary Whitaker's 1973 letter to Senator Jackson: "...The amendment was enacted not to enforce the common carrier provision, but to prevent harm to the public lands and mineral resources of the United States...."[4]

Certain integrated oil companies, by contrast, have long asserted that the effect of the 1935 amendment was to limit the common carrier provision and allow the common carriage requirement to be fulfilled by non-discriminatory purchasing (e.g., the price it paid to others when purchasing).[5] They have further asserted Department of the Interior agreement in this interpretation by quoting the Department as finding that "Arm's length

---

[1] The Solicitor's office is currently preparing a memorandum addressing BLM's legal questions relative to the common carrier issue.

[2] H-16 at 2.

[3] H-11 at 2.

[4] H-6 at 10.

[5] H-2 at 62. H-5 at 25-27. H-7 at 7. H-8 at 20. H-9 at 18.

purchases and exchanges satisfy the MLA requirement of purchasing without discrimination."[6] However, the same correspondence also stated, "As to pipelines refusing to transport oil of another owner, no specific occurrence has been identified."[7] The written refusals to transport oil of another owner which surfaced in the LB II litigation[8] appear to provide basis for reconsideration.

Although the BLM has not received any documented complaints[9], correspondence between independent producers and integrated oil companies concerning requests for common carriage through pipelines holding rights-of-way pursuant to the MLA is consistently denied. The pipeline companies consistently and unequivocally state that the pipelines are private facilities which transport only their own oil.[10] Indeed, the companies themselves have stated that "Getty and Texaco have always operated its line privately and have never carried oil for others for compensation."[11]

Separately, and independently of the common carrier issue, the MMS has unsuccessfully pursued the under-pricing / royalty valuation issue in California. The basis of prior allegations has been limited to the inconsistency between (1) posted prices and prices implied by refinery net-back analyses, and (2) gravity differentials in the California market relative to the mid-continent market. The LB-II litigation appears to offer a more compelling argument by explaining the under-pricing through linkage to the common

---

[6] H-2 at 64. H-7 at 8. Reference is to a memorandum from Assistant Secretary, Land and Minerals Management, to Secretary of the Interior (February 17, 1987); and letter from James M. Hughes, Deputy Assistant Secretary, Land and Minerals Management, to Representative Philip R. Sharp (April 19, 1990).

[7] Letter from James M. Hughes, Deputy Assistant Secretary, Land and Minerals Management, to Representative Philip R. Sharp (April 19, 1990).

[8] H-12, H-14, and H-15.

[9] Burton J. Stanley in the Office of the Regional Solicitor, Pacific Southwest Region, in commenting on 1991 IG finding of lack of compliance, explained the lack of complaints as follows: "The problem arises because there is no state or federal agency capable of assuming regulatory jurisdiction over these pipeline companies. An independent oil producer is indeed unlikely to challenge the operation of a pipeline company in a proprietary manner if, in fact, he can obtain no meaningful relief even if he complained." [Memorandum BLM.PS.1308 dated January 14, 1990, contained in IG audit report no. 91-I-503 dated February 1991.]

[10] H-15. H-14.

[11] H-2 at 50.

carrier issue and other price, exchange, and purchasing practices of the integrated firms in California.

From an economic perspective, a vertically integrated firm possessing strong market or monopoly power cannot be presumed to behave as a common carrier by acting as a common purchaser; even if it stands ready to purchase all oil tendered at its offering price. That is because such a firm can exercise its market power by offering only very low prices and / or exchanging only with large location differentials. This was precisely the concern that led to section 28 in the first place.[12]

That the effect of continuing to serve only as a common purchaser has resulted in field prices significantly below fair market value is freely admitted by the integrated companies[13]; and is attested to by the difference in their practices when dealing with each other. That is, records of integrated oil companies show that they believed that the prices paid for heavy crudes, in particular, were "less than true value".[14] It is specifically this

[12] The legislative history shows that pipeline companies were behaving as common purchasers for many years prior to the MLA. It this practice were acceptable to the Congress, there would have been no reason to include section 28 at all. Indeed, the nature of the problem then, as now, is that pipeline companies act *only* as common purchasers and, by not providing to common carriage, enforce their low field price objective.

[13] B-1 at 13-26.

[14] B-1 at 13-15.

under-pricing that led to the development of the 3-Cut exchange.[15] Court records show, for example, a Texaco official explained the need for the 3-Cut exchange as:

> Generally speaking badger [3-Cut] exchanges are considered to be the most equitable arrangement for both parties and, in many instances, posted price or gravity barrel exchanges are very adverse economically to one of the parties to the exchange.[16]

Similarly, on deposition, ARCO's Crude Supply Manager characterized the 3-Cut:

> Q. The question I am asking you is simply, do you agree that 3-cut exchanges were utilized in California because crude oils were not priced according to their value in California?...THE WITNESS: If you are looking for a simple answer, yes.[17]

It is further important to note that the 3-cut exchanges were not "a wash", but produced very large imbalances, whether measured in barrels or dollars. The persistence of the large imbalances necessitated periodic settlements between the exchanging parties to reduce the imbalances.[18] Since such payments were the result of exchange sales, they should be viewed as a part of the payment for the crude, even though such payment may

---

[15] In simple terms, the 3-Cut exchange was a mechanism allowing crude to be exchanged a cut at a time, as if it were refined product. This allowed for pricing consistent with the crudes actual market value, rather than the posted price. This exchange basis (later giving way to gravity balancing exchanges) was used by the integrated oil companies when dealing among themselves; since valuation at posted prices would severely disadvantage one of the parties, and therefore not acceptable. Posted prices (or location discounts from posted prices) were used only for dealing with independent producers (and valuation of crude for royalty purposes). Although it is easiest to understand the operation of the 3-Cut exchanges involving pipeline transportation (and the majority did appear to involve pipelines), such exchanges were used even when pipeline transportation was not involved, as when deliveries were by tanker. Although it is claimed that 3-Cut exchanges were used only ease the refiner's burden of adding and subtracting exchanged crudes without protracted negotiations, as well as providing a means for automatic maintenance of a quality balance, it is important to recognize that 3-Cut exchanges were never used outside the California market.

[16] B-1 at 14.

[17] B-1 at 16.

[18] B-1 at 19.

have occurred outside the sale contract itself. To the extent that such payments were related to the sale or exchange of crudes lifted from Federal leases (including those crudes exchanged for similar, non-Federal crudes before reaching their final destination), they are properly royalty bearing.

There are also reported to be other indicia of significant under-pricing of California crudes, including quantitative analyses indicating that the amount of such under-pricing may have been as high as \$2 - \$4 per barrel. These include comparison of posted prices with:

- Comparable ANS crudes;
- Crudes sold at auction, including Federal auction sales; and
- Prices obtained from traders.[19]

Program Contact: Bob Berman, Office of Policy Analysis, 208-3751.

[19] Much of the economic analyses is currently under protective order. Its existence and results are reported based on discussions with the individual who conducted the analysis.

COPY

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS
LUFKIN DIVISION

xxxxxxxxxxxxxxxxxxxxxxxxxx

UNITED STATES OF AMERICA, ex rel. J. BENJAMIN JOHNSON, JR., et al.,
Plaintiffs, : C.A. No. 9:96CV66

v.

SHELL OIL CO., et al., : PAGES 1 through 329
Defendants.

xxxxxxxxxxxxxxxxxxxxxxxxxx

Videotape Deposition of Danielle Brian Stockton

Washington, D.C.

Friday, July 23, 1999

Reported by: Joanne Liverani, RMR
JOB NO. 123221

July 23, 1999
10:08 a.m.

Deposition of Danielle Brian Stockton, held at the offices of:

McGuire, Woods, Battle & Boothe, LLP
Washington Square, Suite 1200
1050 Connecticut Avenue, Northwest
Washington, DC 20036-5317

Pursuant to notice, before Joanne Liverani, RMR, a Notary Public of the District of Columbia.

APPEARANCES:
Brand, Lowell & Ryan
For the WITNESS AND POGO
923 Fifteenth Street, Northwest
Washington, DC 20005
(202)662-9700
BY: Stanley M. Brand, Esq.
Andrew Herman, Esq.
-and-
Packard & Packard
87 Interstate 10 North
Number 225
Beaumont, Texas 77707
(409)832-2300
BY: Dan Packard, Esq.

United States Department of Justice
Civil Division
For the Plaintiff, UNITED STATES OF AMERICA
PO Box 261
Ben Franklin Station
Washington, DC 20044

(202)514-6832
BY: Robert J. McAuliffe, Esq.
Brian Wilson, Esq.

Provost Umphrey Law Firm, LLP
For the Relators MARTINECK AND JOHNSON
1350 New York Avenue, Northwest
Suite 1040
Washington, DC 20005-4798
(202)637-0400
BY: Traci L. Buschner, Esq.

McGuire, Woods, Battle & Boothe
For the Defendant, CONOCO INC.
Washington Square, Suite 1200
1050 Connecticut Avenue, Northwest
Washington, DC 20036-5317
(202)857-1704
BY: George J. Terwilliger, III, Esq.
Charles McIntyre, Esq.
-and-
Russell D. Howell, Esq.

Had you -- did you relate to Assistant Secretary Armstrong when he mentioned Mr. Berman to you that you had already been in touch with him?

A No, I did not.

Q Was there reason? I mean did you specifically not do that for a reason?

A Sure.

Q Which was?

A Well, it was clear by then that this was not the official policy of the Department of Interior, and there was no reason to give the name of a guy who was going against the whole agency. I have seen what happens to whistle-blowers.

Q So you were considering Mr. Berman at this point to be an ally, as well as a confidential source of information to you?

A He had helped me understand issues and he really was a great advocate on this issue internally.

By the time I was getting the Freedom of Information Act documents, it was clear he had

been advocating this position for many years.

Q So fair to say that you viewed him as important to your pursuit of your position on this issue, true?

A He was helpful in my understanding the issue, yes.

Q At this point you had a strategy on the issue; correct? Your strategy -- is that correct?

A No.

Q You did not have a strategy?

A I don't know what you mean exactly.

Q Didn't you have a plan for how you were going to pursue this issue, advocate POGO's point of view on it?

A Well, in the sense that we have a general plan that we expose, we investigate an example of waste or fraud, we --

Q I understand --

A Well, you asked me a question.

Q Go ahead.

A We gather all the evidence. We produce a report typically. We then work with policy

makers to help them understand and point out to them what evidence we found, and we try to point to some ways of remedying the problem.

Q And accepting all that, is it fair to say that by the time you met with Mr. Armstrong in November 1994, that you considered Mr. Berman an ally and an asset in that effort, as you described it, on the oil royalty question?

A Yes.

Q Had Mr. Berman provided you with any documents, up to November of 1994?

A No. He never provided me with any documents.

Q Never provided you with any documents?

A No.

Q You are certain of that?

A Well, I know he didn't give me any documents. I don't know that he wasn't one of the anonymous people, but I doubt it because the documents that he wrote all came to me ultimately through Freedom of Information Act.

Q Excuse me.

So we can save each other a lot of time here, to the best of your knowledge, not just through November of 1994, but during the entire period of your work on this issue, let's say up to the time you filed the lawsuit, Mr. Berman never provided you with any documents?

A That's correct.

Q You received documents from anonymous sources, and you don't -- the best of your belief is that they were not from Mr. Berman?

A That's correct.

Q Or at Mr. Berman's direction someone else supplied them to you?

A That's correct.

Q Did he provide you with information that was useful to you in identifying specific documents, that you should request, under FOIA?

A I do recall that he helped once in drafting language for a Freedom of Information Act request.

Q When was that?

A Oh, I don't know. I had so many. I